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SUBJECT: Decentralization: challenges and opportunities in East Java

1. (SBU) Summary: Decentralization is nearly universally regarded as a positive policy. However, there is a wide range of performance with decentralization's increased local government authorities and budgetary allocations. East Java is one of the most productive, well-performing provinces in Indonesia. And there are numerous decentralization success stories at the district level. Decentralization is promoting competition within the province, spurring innovation, investment, and increasing socio-economic indicators in some districts. Yet, there are structural, resource, and central government constraints that limit the benefits of regional autonomy. Local leadership continues to be the key factor in determining decentralization's success. End Summary.

East Java: engine of Indonesian economy

2. (SBU) East Java is the "bread basket" and key economic engine of Indonesia. East Java supplies 35-40% of Indonesia's rice and sugar. Large industries - oil, cement, manufacturing, and others - drive economic growth in the region. Divided into 38 districts (kabupaten / regencies and kota / cities), East Java offers both success stories and failures of regional autonomy policies. Some district governments - such as Tulungagung, Pasuruan, and Pamekasan - have used increased local authorities to improve public service delivery. Others have wasted increased local government resources and failed to improve socio-economic welfare indicators.

Widespread support for decentralization

3. (SBU) Decentralization is nearly universally regarded as a positive concept and policy approach, particularly at the provincial and district levels. Since 2001, the central government has continued to push significant resources and authorities to the district level as part of Indonesia's broader reform movement. Public service delivery - particularly education and health - is the responsibility of the local government, compared to the more centralized practices of the Suharto era. With the increased authorities and responsibilities, the central government has also increased its direct budget transfers to the district level.

Decentralization spurs regional competition

4. (SBU) Local leaders and citizens argue that local government is more responsive to citizens' needs during the "decentralization era" as more money and authority are devolved to the district level. Decentralization policies can spur regional competition to attract both investment and prestige. At the provincial and district level, some local governments are setting progressive investment policies to attract investment. In East Java, districts also compete for prestige as the Jawa Pos Institute for Pro-Autonomy gives annual awards to well-performing local governments. Decentralization also gives local governments more freedom to determine policy priorities.

In the remote district of Pacitan, birthplace of President Yudhoyono, the district government devotes over 40% of the budget to education.

But it's all about the follow-through

15. (SBU) Despite support for the concept of decentralization, there is widespread frustration with its implementation. Quality of budget spending is often poor, even in some highly regarded districts. Many districts spend 60-70% of their budget on overhead (e.g., salaries, buildings), according to a senior Ministry of Home Affairs official. Only 30-40% of local governments are directed to public service delivery. In Pacitan district, about 65% of the budget is devoted to overhead. Other East Java districts - including Ngawi and Madiun City - reflect this trend. The budget percentages should actually be flipped: 30-40% to overhead and 60-70% to public service delivery, according to the Ministry of Home Affairs official. Two of the highest performing districts - Sragen in Central Java and Jimbrana in Bali - achieve that ratio.

Multiple constraints to decentralization

16. (SBU) Structural, resource, and central government constraints limit local governments' effectiveness in implementing regional autonomy policies.

17. (SBU) STRUCTURAL: Over 90% of the local government budget in many districts in East Java comes from direct transfers from the central government. Local taxes often generate 10% or less of the local government budget. The exception is urban areas, such as the

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provincial capital Surabaya, which can generate more local revenue from area businesses. The central government-based budget framework limits the incentives for local government to attract investment, as local areas receive only limited additional tax revenues. The budget framework also encourages local government leaders to come to Jakarta often to lobby ministries - particularly the Finance Ministry - for special budget consideration, which can lead to corruption.

18. (SBU) Another area with high potential for corruption is the local budgeting process, particularly the role of the local legislative body (DPRD). The local legislative body and local government administration engage in negotiations to determine budget priorities after receiving central government outlays. Construction, service contracts, and other budget expenses are often rife with corruption and nepotism, according to civil society contacts throughout East Java.

19. (SBU) RESOURCE: Poor infrastructure impedes growth. Many remote districts, such as Pacitan and Ngawi, are several hours drive via poor roads from major provincial hubs. The higher the level of government, the poorer the commitment to infrastructure, according to Regional Economic Development Institute Director Indra Fauzi. Eight districts in East Java placed in the "top ten" local government infrastructure ranking conducted by the NGO Regional Autonomy Watch (KPPOD). Using roads as an example, local government-financed projects are generally good in East Java. Provincial and national government-financed road projects have been poorly financed, such as the proposed South Java highway that would connect many remote South Java cities to provincial hubs. Jakarta has recognized the importance of infrastructure, increasing infrastructure spending in the national budget and adding \$1 billion in infrastructure spending to the stimulus package.

110. (SBU) Human resources is another constraint often cited by government officials and civil society. Despite often uneven civil service performance, huge amounts of local government budgets - over 50% in many districts - go to salaries. Poor civil service performance leads to delays in budget disbursement from central to district governments. Some district governments are late in submitting budget proposals to the provincial and national governments, which delays the entire budgeting process.

¶11. (SBU) CENTRAL GOVERNMENT: The long arm of Jakarta constrains regional autonomy and decentralization. The central government has devolved significant resources and authorities to local government, but still retains powers that require local governments to continually look to the central government for instruction or resources. Local governments are often bound by restricted central government budget outlays for specific projects, according to a senior research at the Jawa Pos Center for Pro-Autonomy. For example, central government funds allocated to a district for a health project cannot be transferred to an education project even if there is greater need for an education project. This central government control stifles local government creativity and responsiveness. Beyond government bureaucracy, political parties at the national level attempt to influence their parties' local elected leaders. For example, national level PDI-P leaders instructed PDI-P district level elected leaders to not execute the central government's community-level poverty reduction programs (e.g., PNPM).

¶12. (SBU) In another example of the long arm of Jakarta, the Ministry of Home Affairs issued a regulation in mid-April that requires all foreign government officials to request 14-day advance permission for any local government meetings. Some local leaders disregard this regulation; others adhere to it. Beyond being bureaucratically untenable, this regulation - like many others - demonstrates ministries' centralized focus.

Leadership determines success

¶13. (SBU) Local leaders are the most important factor in determining the success or failure of regional autonomy, according to government and civil society contacts. Some district leaders in East Java have used decentralization to spur innovation in providing public services and attracting business. Local leadership is also essential as there are many overlapping or contradictory government regulations. If a local leader does not take action, government programs can be stifled. Local legislatures are a place of corruption and often hamper policy-making and budget allocation, according to contacts. In the end, decentralization is providing more opportunities for local-level leadership and accountability. Constraints are apparent and the central government's influence remains strong, but support for decentralization remains high.

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